MOTION FILED
SEP 22 1977

No. 77-454

IN THE
Supreme Court of the United States
OCTOBER TERM, 1977

MOORMAN MANUFACTURING COMPANY,
Appellant

v.

G. D. BAIR, DIRECTOR OF REVENUE, STATE OF IOWA,
Appellee

On Appeal from the Supreme Court of the State of Iowa

MOTION OF WILLIAM J. BAUMOL, *ET AL.* FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT AND APPEAL

WILLIAM T. PLUMB, JR.
815 Connecticut Avenue
Washington, D. C. 20006
Attorney for Amici Curiae

WILSON - EPES PRINTING CO., INC. - RE 7-6002 - WASHINGTON, D.C. 20001

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant

v.

G. D. BAIR, DIRECTOR OF REVENUE, STATE OF IOWA,
Appellee

On Appeal from the Supreme Court of the State of Iowa

MOTION OF WILLIAM J. BAUMOL, *ET AL.* FOR LEAVE TO FILE BRIEF AMICUS CURIAE IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT AND APPEAL

The individuals identified below hereby respectfully move for leave to file the attached brief *amicus curiae* in support of this appeal. The consent of the attorney for the Appellant has been obtained. The consent of the attorney for the Appellee was requested but refused. The Appellant's letter of consent and the Appellee's letter of refusal are submitted herewith.

The identities of the movants and brief statements of their qualifications are as follows:

WILLIAM J. BAUMOL, Professor of Economics, Princeton University and New York University; formerly Vice President, American Economic Association.

OSWALD H. BROWNLEE, Professor of Economics, University of Minnesota; formerly Deputy Assistant Secretary of the Treasury.

JAMES M. BUCHANAN, University Professor of Economics and Director, Center for the Study of Public Choice, Virginia Polytechnic Institute and State University; formerly President, Southern Economic Association; Vice President, American Economic Association.

COLIN D. CAMPBELL, Professor of Economics, Dartmouth College.

OTTO A. DAVIS, Professor of Political Economy and Dean of the School of Urban and Public Affairs, Carnegie-Mellon University.

MILTON FRIEDMAN, Paul Snowden Russell Distinguished Service Professor of Economics, University of Chicago; formerly President, American Economic Association; Alfred Nobel Memorial Prize in Economic Science (1976).

C. LOWELL HARRISS, Professor of Economics, Columbia University; formerly President, National Tax Association.

PAUL W. MACAVOY, Professor of Economics, Yale University; formerly member, President's Council of Economic Advisers.

HENRY G. MANNE, Distinguished Professor and Director, Law and Economics Center, School of Law, University of Miami.

WILLIAM H. MECKLING, Professor of Economics and Dean, College of Business Administration, University of Rochester.

DAVID I. MEISELMAN, Professor of Economics and Director, Reston Economics Program, Virginia Polytechnic Institute and State University; formerly Chairman, Presidential Task Force on Inflation.

MANCUR L. OLSON, Professor of Economics, University of Maryland; formerly Deputy Assistant Secretary, Department of Health, Education and Welfare.

RICHARD N. ROSETT, Professor of Business Economics and Dean, Graduate School of Business, University of Chicago.

LESTER C. THUROW, Professor of Management and Economics, Massachusetts Institute of Technology.

MURRAY L. WEIDENBAUM, Mallinckrodt Distinguished University Professor of Economics and Director, Center for the Study of American Business, Washington University, St. Louis; formerly Assistant Secretary of the Treasury for Economic Policy.

The interest of the movants in this case arises from the fact that, as academic economists of long and distinguished experience, they are greatly concerned that affirmance of the decision below, which held constitutional the apportionment of net income for Iowa tax purposes based upon the single factor of the place of sale, without regard for the place where capital and labor were employed in producing the income, will raise unacceptable barriers to interstate competition in the national common market and contravene a fundamental principle of federalism embodied in our Constitution.

When the same constitutional issue was previously before this Court, in *General Motors Corp.* v. *District of Columbia*, 380 U.S. 553 (1965), October 1964 Term No. 352, the record contained expert testimony concerning the economic effects of the use of the single factor formula based upon sales. Since the case was decided (against

the use of the single factor formula) on statutory rather than constitutional grounds, that testimony was not relied upon or referred to by the Court in reaching its decision, although its substance was thoroughly woven into the Court's reasoning. The present record does not contain comparable economic testimony, and the economic effects cannot as adequately be demonstrated merely by argument of counsel. Movants respectfully entreat the Court, therefore, to consider the economic effects, presented as argument by a distinguished panel of economists, based upon facts of which the Court may take judicial notice.

Respectfully submitted,

WILLIAM T. PLUMB, JR.
Attorney for the Amici Curiae

IN THE
Supreme Court of the United States
OCTOBER TERM, 1977

No. 77-454

MOORMAN MANUFACTURING COMPANY,
Appellant

v.

G. D. BAIR, DIRECTOR OF REVENUE, STATE OF IOWA,
Appellee

On Appeal from the Supreme Court of the State of Iowa

BRIEF AMICUS CURIAE SUBMITTED BY WILLIAM J. BAUMOL, *ET AL.* IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT AND APPEAL

This brief is submitted by the following individuals in their personal capacities. Biographical information is included solely for purposes of identification, and no position is taken by any organization or institution mentioned in connection with the named intervenors.

Interstate competition, unhindered by state barriers to trade, is basic to the American federal system of government. This view has its most obvious origin—whether

it be called economic or political—in the United States Constitution. The principle has been reinforced repeatedly through two centuries of consistent holdings by this Court, as well as through such important economic legislation as the Sherman Anti-trust Act and other laws aimed at preserving competition. But the battle to preserve a national common market and free trade is an unending one, for in a dynamic federal system like ours, state regulations or taxes can have decidedly different economic impacts at different times and under different circumstances.

This point is well illustrated by the Iowa tax at issue in the instant proceedings. This tax, as will be shown, has under its existing circumstances, the anti-competitive effect that would seem to signify its unconstitutionality. And it is the effect on competition, not the form of a particular tax, to which the constitutional provision barring state interferences with interstate commerce must logically be related. It is also this market effect on competition, and not the structure of the Iowa tax as such, which gives rise to the belief of the amicus petitioners that their own interests, as well as those of all American consumers, are best served by constitutional preservation of the American common market.

One of the most important ways in which competition controls economic activity is to create pressures to eliminate higher cost producers. When these higher costs are due to inefficient management or inefficient production techniques, this pressure to eliminate certain firms or force them to perform more efficiently is unequivocally socially desirable. However, competition will have this excluding effect regardless of the particular cause of higher costs. Thus the effects of a differentially higher tax rate will be precisely the same on a firm in a competitive industry as will a poor management policy that "costs" the same amount. But in the tax case com-

petition is actually prevented from performing the socially useful function of eliminating undesirable economic inefficiencies. And this is exactly the effect of the Iowa "single-factor" tax formula when adopted in the face of the otherwise universal use of a three-factor attribution test.

The application by Iowa of a corporate income tax based on the single-factor attribution of gross revenues necessarily increases the cost of doing business in Iowa of a foreign corporation compared to the cost of a competing domestic firm. The point can be easily illustrated by numerical examples using some arithmetically simplifying assumptions.

Suppose that two identical corporations, one domiciled in Iowa and one domiciled in Illinois, each have the same total sales equally divided between the two states. Suppose further that the total property and payroll of each corporation rests exclusively in the state in which it is domiciled, and that each corporation has a total income (taxable accounting profits) of $1 million. Finally, suppose that both Iowa and Illinois levy a 5 percent income tax. Now we consider the effects of applyng the tax using different tax formulas.

If Iowa and Illinois use a single-factor formula, that is, one levying the 5 percent tax exclusively on the basis of income attributable to the proportion of total sales made in each state, then the tax formula is:

$$\frac{\text{sales in a state}}{\text{total sales}} \text{ X total net income X } 0.05. \qquad (1)$$

We assume that each corporation has half of its sales in each state, and thus its tax payments to each state would be:

$$(0.50)\ (1{,}000{,}000)\ (0.05) = \$25{,}000 \qquad (2)$$

and the pattern of tax payments and receipts is that shown in Table 1:

TABLE 1

	Taxes Paid to Iowa	Taxes Paid to Illinois	Total Taxes Paid by each Corporation
Iowa Corp.	25,000	25,000	50,000
Illinois Corp.	25,000	25,000	50,000
TOTAL	50,000	50,000	

If both Iowa and Illinois again levy the same 5 percent income tax but use the traditional three-factor formula, which is:

$$\frac{\frac{\text{Sales in State}}{\text{Total Sales}} + \frac{\text{Property in State}}{\text{Total Property}} + \frac{\text{Payroll in State}}{\text{Total Payroll}}}{3} \times \text{Total net income} \times 0.05, \qquad (3)$$

then each corporation's payment to its state of domicile would be

$$\frac{0.5 + 1 + 1}{3} \times 1{,}000{,}000 \times 0.05 = 41{,}667, \text{ and} \qquad (4)$$

its payment to the state in which it is a foreign corporation would be

$$\frac{0.5 + 0 + 0}{3} \times 1{,}000{,}000 \times 0.05 = 8{,}333, \qquad (5)$$

and the pattern of tax payments and receipts would be that shown in Table 2:

TABLE 2

	Taxes Paid to Iowa	Taxes Paid to Illinois	Total Taxes Paid by each Corporation
Iowa Corp.	41,667	8,333	50,000
Illinois Corp.	8,333	41,667	50,000
TOTAL	50,000	50,000	

But now consider the basic situation at issue in the present case, in which Iowa uses the single-factor formula, whereas Illinois uses the three-factor formula. Utilizing the same data specified earlier, the pattern

of tax payments and receipts is now that shown in Table 3:

TABLE 3

	Taxes Paid to Iowa	Taxes Paid to Illinois	Total Taxes Paid by each Corporation
Iowa Corp.	25,000	8,333	33,333
Illinois Corp.	25,000	41,667	66,667
TOTAL	50,000	50,000	

Under the simplifying hypothetical conditions stated earlier, each state's tax receipts are the same ($50,000) in each tax situation. But, as Table 1, 2 & 3 demonstrate the corporations' tax payments will be the same only if both states use the same formula. If Iowa uses the single-factor method while Illinois uses the three-factor method, then, as shown in the last column of Table 3, the Iowa corporation pays exactly one-half the amount of total state income taxes ($33,333) paid by the Illinois corporation ($66,667).

In practice, of course, these relative differentials will be smaller or greater depending upon the actual tax rates levied by the various states involved, and upon the actual proportions of domestic to foreign sales, payrolls, and properties of individual corporations. Only the magnitudes will change with these factors, however, and not the direction of the impact. The general principle will apply in all cases.

As a result of Iowa's decision to apply a single-factor formula in the context of general use of the three-factor formula by other states, Iowa corporations will enjoy lower total state income tax payments than foreign corporations doing business in Iowa, and these foreign corporations will be burdened by higher payments to Iowa than would otherwise be true. The necessary effect of this situation is to improve the competitive position of Iowa corporations by increasing the costs of foreign competitors.

Several specific aspects of this analysis deserve emphasis. First, the constitutional right of Iowa to levy taxes of any particular rate is not here questioned. What is questioned is the choice of a tax formula that effectively discriminates in favor of domestic corporations at the expense of foreign corporations and thus lessens competition. That is the only effect that follows necessarily from Iowa's selection of the one factor attribution, since it cannot even be concluded a priori that Iowa's choice of a single-factor rather than a three-factor formula will yield higher receipts. That will depend, among other reasons, upon how these corporations respond to the tax. So we can logically conclude that if Iowa's objective is simply to increase its tax revenues, then it could simply raise its tax rate while applying the three-factor formula. That it does not pursue that strategy would seem to indicate that protection of domestic corporations rather than merely revenue considerations plays an important part in Iowa's decision to use a single-factor formula.

It should also be noted that the anti-competitive effect of this tax works in still another way. Many taxes are properly and logically justified on the basis of benefits provided to the taxpayer by the taxing authority. These include police and fire protection, courts, and numerous other amenities. To the extent that the instant Iowa tax receipts are utilized to provide such benefits, they will naturally disproportionately benefit Iowa corporations. While it is not suggested that this disparate effect is necessarily in and of itself constitutionally unsound, it does reinforce the position already discussed that the one factor attribution in a context of all other states using the three factor test does have undesirable anti-competitive effects. Here, however, the discrimination is on the side of the benefits rather than the costs, as Illinois corporations are taxed for service disproportionately benefiting their Iowa competitors.

As the political pressures build in one state and then another to secure these hidden competitive benefits for domestic businesses through selection of appropriate tax formulas, the specter of a severely damaging, yet not openly declared trade war between states begins to threaten. No conceivable economic advantage could justify the economic costs attendant upon such conflict.

As mentioned earlier, the tax paid to any and all states goes into the determination of the total cost of production for a given corporation. Clearly, to survive in the long run, all these costs must be recovered. But this cost recovery can only be accomplished ultimately by a sale of the goods produced. In this sense then revenue from sales includes recovery of labor and property costs wherever they may have been incurred, and therefore a gross revenue tax necessarily constitutes a tax on every component factor of production, regardless of where located.

Thus the Iowa tax based on sales revenue for an Illinois corporation producing in Illinois in effect becomes a tax on property and payrolls in Illinois. But these items are already being taxed in Illinois via the three factor formula. Therefore another economic effect of Iowa's one-factor formula is to let it tax labor and productive capital that is in no way physically associated with the State of Iowa. This is, of course, an alternative way of looking at the anti-competitive effect described earlier, and it is mentioned here primarily to demonstrate that the economic consequences of the Iowa formula may run afoul of more than one constitutional standard for an acceptable state tax.

A common market or free trade area encourages production to be undertaken by the least-cost producers regardless of their domicile. The organization of economic activity according to this principle benefits consumers by giving them a wider choice of goods and services at lower prices, and it rewards producers for more efficient, lower-

cost production. Society collectively benefits, since lower-cost production releases resources that can now find added use to increase the health and welfare of all members of society. Courts should be ever mindful of the threat states can pose to the effective workings of a free and open marketplace.

Regardless of the intention of the framers of the Iowa tax the effect is clearly contrary to the principle of federalism that underlies the Commerce Clause of the United States Constitution. The necessary effect of this tax is precisely the same as an Iowa tariff imposed on Illinois or other corporations doing business in Iowa in competition with Iowa companies. To allow this state of affairs to persist in any state is to invite, indeed even to force, retaliation by other states. It presents the quintessential situation in which the Supreme Court has the responsibility for preserving the Federal system in its economic component. It is a matter of utmost importance that this Court address itself once again to this issue and prevent the development of debilitating internal economic conflict in the United States.

Respectfully submitted,

WILLIAM J. BAUMOL
OSWALD H. BROWNLEE
JAMES M. BUCHANAN
COLIN D. CAMPBELL
OTTO A. DAVIS
MILTON FRIEDMAN
C. LOWELL HARRISS
PAUL W. MACAVOY
HENRY G. MANNE
WILLIAM H. MECKLING
DAVID I. MEISELMAN
MANCUR L. OLSON
RICHARD N. ROSETT
LESTER C. THUROW
MURRAY L. WEIDENBAUM
Amici Curiae

WILLIAM T. PLUMB, JR.
Attorney for Amici Curiae